Central Bank Weekly 28th July: Previewing RBA, BCB and BoE; Reviewing FOMC, BoJ and ECB

PREVIEWS:

RBA ANNOUNCEMENT (TUE): There are mixed views regarding next week's RBA meeting as a recent Reuters poll showed that 20 out of 36 economists surveyed expect a 25 bp rise in the Cash Rate to 4.35% and the remaining 16 calling for no change, while money markets are pricing in a 79% probability for the central bank to continue its pause and just a 21% chance for a 1/4 point hike. As a reminder, the RBA kept rates unchanged at the previous meeting vs near-evenly split analyst expectations between a 25bps hike or hold, while the language remained hawkish as it noted that the Board is still resolute in its determination to return inflation to target and further tightening of monetary policy may be required to ensure that it does within a reasonable timeframe, but added that it will depend upon how the economy and inflation evolve. Furthermore, the minutes from that meeting revealed that the Board considered holding rates steady or hiking by 25bps and there was a strong case for both, but it ultimately judged that arguments for holding steady were stronger, while it agreed some further tightening may be required and would reconsider the case at the August meeting. As such, money markets had been pricing a near coin-flip between a 25bps hike and a pause, although this has since shifted to lean heavily towards a pause following the release of softer-than-expected CPI data for Q2 which printed at the slowest quarterly pace of increase since September 2021, at 0.8% vs. Exp. 1.0% (Prev. 1.4%) QQ and 6.0% vs. Exp. 6.2% (Prev. 7.0%) YY, and weaker than forecast final June retail sales. However, a resumption of the hiking cycle cannot be ruled out given that inflation remains well above the central bank's 2%-3% target range and Governor Lowe has stressed a seriousness about getting inflation back to target. Another key development that needs to be considered is the government's recent decision to appoint Deputy Governor Bullock as the next Chief to replace Lowe when the latter's term ends around mid-September, which leaves just two meetings under his stewardship and could compel the central bank to wait for the incoming Governor to take charge before resuming its heavy lifting especially given that Lowe had faced fury over the RBA's past decisions to repeatedly hike interest rates.

BCB ANNOUNCEMENT (WED): The most recent economist polls have seen lower inflation projections for both 2023 and 2024, and now see IPCA inflation falling to 4.90% by the end of this year, and easing further to 3.9% by the end of 2024. "Inflation in Brazil continues to surprise to the downside, and overall conditions for H2 remain benign," Pantheon Macroeconomics said, "the COPOM will welcome the inflation slowdown and likely will cut rates by 50bps next week to 13.25%." And analysts believe that slowing inflation will allow the BCB to again lower rates at the remaining three meetings this year, and predict the Selic will end this year at 12.00%, and at 9.50% next year. Pantheon says, however, that bigger rate cuts are needed: "100bps is preferable, but the COPOM signalled a 'parsimonious' start to the easing cycle, so we can't rule out a modest 25bps, aiming to test the waters, particularly the BRL's performance after the initial cut." Ahead, Pantheon sees inflation staying low due to a slower economy and higher borrowing costs, and to provide the economy with support, it thinks rates may be lowered to 8% by mid-2024.

BOE ANNOUNCEMENT (THU): After stepping back up to a 50bps increment of rate hikes at the June meeting, the MPC is expected to return to a smaller 25bps cadence, taking the Base Rate to 5.25%. Such a move is expected by 42 /62 economists surveyed by Reuters, whilst markets assign a circa 75% chance to such an outcome. Expectations for the BoE to step down to a 25bps increment stemmed from the June CPI report which saw Y/Y CPI pullback to 7.9% from 8.7%; matching the forecast of the Bank's May MPR. Note, there have been some encouraging signs for core inflation too with the Y/Y rate pulling back to 6.9% from 7.1%, whilst the widely-watched services metric fell to 7.2% from 7.4%. Elsewhere on the data front, wage metrics ticked higher in the 3M/YY period to May, however, this was accompanied by an increase in the unemployment rate to 4% from 3.8%. From a growth perspective, May's M/M GDP release revealed a 0.1% contraction, whilst more timely survey data saw the UK's composite PMI slip to 50.7 from 52.8 amid a softening in both the manufacturing and services prints. As such, there are reasons for caution on the MPC, but likely not enough to deter policymakers from pulling the trigger on another hike. Of great interest to the market will be how the Bank chooses to guide expectations beyond the August meeting. From a quantitative perspective, Pantheon Macroeconomics suggests that the forecasts from the MPR will "cast doubt on whether interest rates need to rise further at all". The consultancy notes that, the May MPR stated that based on a Bank rate of 4.5% CPI was expected to decline to 0.7% in two years' time and therefore with a rate assumption that will be 75bps higher, inflation will likely still be well below target over the medium-term. That said, it is worth noting that the MPC is currently placing less weight on its forecasting given recent upside surprises in inflation data. In terms of the breakdown of views on the MPC, with Tenreyro having left the Committee and new member Greene unlikely to rock the boat, an 8-1 vote is expected with

Dhingra the sole dissenter; ING flags the risk of a 3-way split with the possibility of some members preferring to stick to a 50bps cadence. In terms of pricing beyond August, the terminal rate is seen at just above 5.75%, which would imply 50bps of additional tightening post-next week’s meeting.

REVIEWS

FOMC REVIEW: The Federal Reserve raised interest rates, as expected, by 25bps to 5.25-5.50%. The statement was similar to the previous one from June, mentioning the possibility of further rate increases. It acknowledged that the economy is growing at a "moderate" pace instead of a "modest" one, and emphasised that job gains are strong, and the unemployment rate is low. Regarding inflation, the Fed remains cautious and watchful, not overreacting to a single data point. At his press conference, Chair Powell said future interest rate decisions will depend on data and the effects of tightening are not fully felt yet. He mentioned that inflation still has a way to go cool to 2%, but noted improvements in the labour market. However, he highlighted that consumer spending growth has slowed compared to earlier this year. In the Q&A, Powell did not give a clear signal about future rate decisions, again framing it around incoming data, adding that the Fed might raise rates in September if the data supports it. And while he suggested a slower pace of rate increases, lifting them at consecutive meetings was still possible. Powell mentioned that stronger economic growth could lead to higher inflation, requiring a policy response. He discussed the possibility of rate cuts in the future if inflation comes down convincingly. He wants to see inflation decrease sustainably, and wages may play a role in bringing it down. Analysts at ING noted that while the Fed has said that further policy firming may be appropriate, "with two months' worth of data to come before the next FOMC meeting, we suspect evidence of slowing inflation and softer activity won’t make that necessary."

BOJ REVIEW: BoJ kept its policy settings unchanged, as expected with the Bank Rate held at -0.10% and YCC parameters maintained to target 10yr JGB yields around 0%, but it will guide yield curve control more flexibly with its daily fixed-rate purchases of 10yr JGBs at a rate of 1.0% (prev. 0.5%). This essentially means the +/- 50bps band for the 10yr JGB target will now be used as a reference point in market operations, allowing for greater flexibility. This means that the actual yield could occasionally move outside of this range. The BoJ also increased the amount of purchases to JPY 900bln from JPY 875bln. Meanwhile, the Outlook Report saw an upgrade to the FY23 Core CPI forecast to above the BoJ’s 2% inflation target. Delving a bit deeper into the core CPI forecasts, the fiscal 2023 median forecast was raised to 2.5% from 1.8%, but the 2024 median forecast was trimmed to 1.9% from 2.0%, and the 2025 median forecast was maintained at 1.6%. The announcement resulted in plenty of confusion, although the JPY ultimately weakened with the move less hawkish than a recent Nikkei report suggested. At the post-meeting presser, Governor Ueda emphasised the need for continued monetary easing, stating that the Bank is prepared to further ease policy if required. The focus is on enhancing the sustainability of Yield Curve Control, with the BoJ ready to conduct fixed-rate purchases if long-term yields exceed 1.0%. The Bank has created a 0.5-1.0% frame to respond to future risks, with 1.0% defined as a 'just-in-case cap'. Despite some progress towards inflation goals, Ueda expressed uncertainty about future price rebounds, citing risks from a weaker global economy. Ueda said the BoJ is not targeting FX levels, but is including currency market volatility in its measures. Economic uncertainty remains high, and the Bank is prepared to respond flexibly to any materialised risks. Ueda denied any bias towards policy tightening, stating that the aim is to make YCC more sustainable, not to normalise policy. Analysts at Oxford Economics say “Despite today's surprise tweak to YCC policy, we continue to believe that Governor Ueda is determined to avoid premature tightening and will spend another year or so to carefully assess whether the economy is on track to achieve 2% inflation within his five-year term”, although the desk does highlight that “It is not clear at this stage how the 10-year yield will move under the new ceiling of 1.0% and how actively the BoJ will intervene in the market to enhance appropriate yield formation based on economic fundamentals.”

ECB REVIEW: As expected, the ECB pulled the trigger on another 25bps hike, taking the deposit rate to 3.75%. The decision to move on rates again was based on the view that although "inflation will drop further over the remainder of the year", it "will stay above target for an extended period". Aside from the decision itself, focus for the statement was on the modest adjustment to the Bank's language on future decisions whereby the key ECB interest rates will be "set at" sufficiently restrictive levels for as long as necessary vs. the previous wording of "brought to". Elsewhere, the GC also opted to set the remuneration of minimum reserves at 0% (vs. prev. matching the deposit rate) in order to "preserve the effectiveness of monetary policy". In the follow-up press conference, Lagarde offered a more downbeat assessment of the Eurozone economy, noting that the near term outlook is deteriorating and momentum in the services sector is slowing. With regards to today's decision, Lagarde stated that policymakers were unanimous in their stance. When initially questioned over whether she thinks the Bank has more ground to cover, she said the decision will be based on the data and the GC is "open-minded". When pressed on the matter later during the press conference, Lagarde stated that at this moment in time she "would not say so" with regards to there being more ground to cover. On the balance sheet, Lagarde remarked that a reduction has not been discussed and there will be no trade-offs between rates and QT. Overall, the main takeaway ahead of the September meeting is that the ECB is happy to either pause on rate hikes or carry out further tightening, however, any decision to do so will be based on how the data plays out between now and then (note, there are two more inflation reports due before the September decision). As it stands, markets price a 25bps hike in September at around 40%. Analysts at Nordea are of the view that "today’s move was the last hike in the cycle, though risks are tilted towards a further hike in the autumn". The following ECB source reports via Reuters saw that some ECB policymakers do currently favour a September rate hike, but others are eyeing a pause expecting a recession. Meanwhile on reserves, the sources noted the ECB debated raising banks mandatory reserves to 2% from 1%.